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Financial Markets

Irving Trust

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Pent-up frustrations this week reached the blow-off stage in the bond market. Most market participants have long been expecting a recession that would bring relief with respect to inflation and high interest rates. These expectations, however, have been repeatedly dashed as the economy refuses to decline. For too long, portfolio managers have been told that now is a good time to lock in attractive long-term yields only to find more attractive yields the next week with even larger losses in their bond portfolios. Tempers recently have reached the breaking point as data continue to come in showing a growing economy, accelerating inflation, and a possible resurgence of monetary growth. The result has been a buyers' strike and an unprecedented decline in the long-term bond market. Since the beginning of the year, long-term governments have dropped 20%, raising their yields by 275 basis points. On last Tuesday alone, the new 11 3/4s dropped by almost 4%, raising their yield by 65 basis points to 12.60%.

But in this adversity there is opportunity for those who can keep their cool. Looking back a year from now, today's yields are likely to seem very attractive. One may be slightly disappointed at not having hit the precise peak, but that will be a small matter compared with not having participated at these levels at all.

The current atmosphere seems to be the reverse of that at the end of 1976 when bond prices peaked. Back then, the prevailing sentiment was that interest rates would never rise again. Now it seems hard to believe that rates will ever fall. It feels like we're getting near the bottom. In any case, as rates get higher and higher, the odds on that recession get better and better.

The short-term markets were clearly impressed by the Federal Reserve's discount rate hike to 13%. Ninety-day CDs quickly responded by rising 150 basis points to about 15%. But the real question now is will short-term rates stay as high as they are without additional actions by the Fed. They were almost as high last October but dropped when the expected follow-up by the Fed did not materialize. Short rates will likely drop again if no additional tightening is perceived. The Federal Reserve says that the monetary aggregates have been within their targets since the October 6 policy change and that this is just the follow-up that should have been expected under their new policy. Moreover, the Fed contends that policy has been tight since the growth targets for the monetary aggregates are conservative. But the markets seem to think that interest rates matter more than money and that tightening requires higher rates and less liquidity in the banking system not just slow monetary growth.

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Money Market Rates

	2/22/80 (noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company			
Short-term loans to substantial depositors with highest credit rating	16.25%	15.25%	11.75%
Effective since	2/22/80		
Discount Rate at Federal Reserve Bank	13.00	13.00	9.50
Federal Funds	14.50-15.50	14.75	10.00
Repurchase Agreements	13.75	12.50	9.65
U.S. Treasury Issues - Yields			
Bills			
3 months	14.18	13.63	9.75
6 months	14.65	14.15	10.15
1 year	15.18	13.82	10.36
Coupons			
2 years	14.62	13.10	9.88
4 years	14.10	12.25	9.22
7 years	13.30	12.20	9.20
10 years	13.25	12.15	9.13
Long Bond	12.85	12.10	9.08
Negotiable Certificates of Deposit-Secondary Market			
1 month	15.05	13.75	10.00
3 months	15.10	14.00	10.40
6 months	15.35	14.45	10.90
1 year	15.75	13.75	11.00
Bankers' Acceptances			
1 month	14.90	13.60	9.80
3 months	15.50	14.00	10.00
6 months	16.05	14.50	10.15
Eurodollar Deposits			
1 month	16.25	14.75	10.38
2 months	16.38	14.88	10.56
3 months	16.63	15.13	10.75
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	13.25	12.75	9.38
1 month	14.00	13.00	9.75
3 months	13.00	12.25	9.75
Bank Holding Companies			
1 month	14.25	13.13	9.75
Dealer Placed:			
3 months	14.30	13.38	9.80
New Aa Corporate Utility Bond	14.40	13.75	9.60
Tax Exempt			
6 month Project Notes	7.10	6.25	5.15
12 month Project Notes	N/A	N/A	5.35
20 year AAA Bond	7.95	7.50	5.85

This information represents prevailing market yields. It should not be construed as an offering. All yields are on the offered side of the market.

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